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In the Supreme Court of the United States

OCTOBER TERM, 1979

LUTHERAN MUTUAL LIFE INSURANCE COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the United States Court of Claims (Pet. App. A1-A8) is reported at 602 F. 2d 328.

JURISDICTION

The judgment of the Court of Claims was entered on July 18, 1979. The Court of Claims denied a petition for rehearing on September 28, 1979 (Pet. App. A9). By order dated December 21, 1979, the Chief Justice extended the time in which a petition for a writ of certiorari could be filed to and including February 25, 1980. The petition was filed on February 23, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether, in computing petitioner's deduction for dividends to policyholders allowed mutual life insurance companies by Section 809(d)(3) of the Internal Revenue Code of 1954, the amount of petitioner's opening reserve for dividends to policyholders for 1958 should be determined, as the Court of Claims held, by reference to the ending amount of these reserves for 1957, as reflected on its annual statement for that preceding year, or, as petitioner contends, by reference to the dividends that petitioner actually paid to policyholders in 1958.

STATUTES AND REGULATIONS

The relevant portions of Sections 809, 811, and 818 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in Pet. App. C A11-A22.

STATEMENT

Petitioner is a mutual life insurance company organized under Iowa law. In computing its taxable income for the year 1958, the first year such companies were subject to income tax under the Life Insurance Company Income Tax Act of 1959, Pub. L. No. 86-69, 73 Stat. 112, petitioner was entitled, under Section 809(d)(3) of the Internal Revenue Code of 1954, to a deduction for dividends to policyholders as determined under Code Section 811(b). Section 811(b) provides, in pertinent part, that the deduction for dividends to policyholders is computed by adding to (or subtracting from) the amount of dividends actually paid to policyholders during the taxable year the difference between (1) the amount held at the end of such year as reserves for dividends to policyholders payable in the following year and (2) the amount held as reserves for dividends to policyholders at

the end of the preceding taxable year. These reserves are only estimates based on anticipated dividends payable in the following year. Any overestimate or underestimate of the beginning reserve may result in a larger or smaller deduction for dividends to policyholders for the taxable year to the extent that such overstatement or understatement is not matched by a corresponding overstatement or understatement in the ending reserve.

As required by state law, petitioner filed annual statements for 1957 and 1958 with the insurance commissioners of the states in which it did business on the form prescribed by the National Association of Insurance Commissioners (NAIC). Its 1957 annual statement showed $55,000 as dividends due to policyholders and unpaid for that year and $2,000,000 as the estimated amount of dividends payable to policyholders in the following year (1958) (Pet. App. A3). However, in computing the amount of its deduction for dividends to policyholders for 1958 under Section 811(b), petitioner did not use, as its opening reserve for dividends to policyholders, the amounts reported on its annual statement for 1957 as unpaid dividends for 1957 and estimated dividends payable in 1958. Instead, it included in its opening dividend reserve the $55,000 amount of unpaid dividends reported as of the end of 1957, plus the $1,928,455 of dividends that it actually paid in 1958 (Pet. App. A3-A4).

On audit, the Commissioner determined that petitioner's opening dividend reserve for 1958 should have included both the $55,000 of unpaid dividends and the $2,000,000 of estimated dividends for 1958 as reported on its 1957 annual statement (Pet. App. A4). Petitioner paid the deficiency resulting from this and other adjustments,

filed a claim for refund, and, after its disallowance, filed this refund suit in the Court of Claims. The Court of Claims upheld the Commissioner's position. In its view, the language of Section 811(b) and its legislative history compelled the conclusion that in computing its 1958 deduction for dividends to policyholders, petitioner was required to include the estimated amount of reserves for dividends to policyholders as reported in its 1957 annual statement in its opening reserves (Pet. App. A1-A8).

ARGUMENT

1. The decision below correctly held that in computing its deduction for dividends to policyholders, the amount of petitioner's opening reserve for such dividends for 1958 should be determined by reference to the ending amount of these reserves for 1957.

Petitioner argues (Pet. 8-10) that in computing its deduction for dividends to policyholders for the first taxable year in which it was subject to tax under the Life Insurance Company Income Tax Act of 1959, the amount of its reserves for such dividends as of the end of the preceding year, as reflected on its annual statement for that year, should be disregarded, and that the amounts of dividends actually paid to policyholders during 1958 should be taken as its beginning reserves for such dividends. As petitioner views the matter, while the effect of succeeding overestimates or underestimates of reserves for dividends to policyholders will theoretically be "corrected" in some later year, the effect of an overestimate of the beginning reserves for the initial year of taxability will never be subject to any corrective offset

(Pet. 9).[1] Petitioner therefore proposes to correct its own overestimate of such reserves as reflected on its annual statement by reducing its beginning reserves to the amount actually paid out in 1958.

But the defect in petitioner's argument is that the statute simply does not provide for such an adjustment in opening reserves. In computing the deduction for the dividend to policyholders, the statute clearly provides that the amount of the deduction consists of dividends actually paid, increased (or reduced) by the difference between the amount held as reserves for these dividends at the end of the taxable year and the amount held as reserves for this purpose at the end of the preceding year. No provision was enacted with respect to adjusting the opening reserves for the first year. Rather, the opening reserves for the first year, as well as any other year, are those reflected on its annual statement as being held for this purpose at the end of the preceding year.[2]

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[1]Petitioner's argument necessarily rests on the premise that it will not continue to overestimate (or to underestimate) the amount of its reserves over the entire period it remains taxable under the statute. If this were the case, an overstatement in the beginning reserves for this purpose would never reduce the amount of the deduction allowable under Section 809(d)(3) as long as such an overstatement continues to be reflected in the company's ending reserves.

[2]In enacting the Life Insurance Company Tax Act of 1959, Congress referred to computations made by the life insurance companies in their required NAIC annual statement. Section 818(a) of the Code; *Commissioner* v. *Standard Life & Acc. Ins. Co.*, 433 U.S. 148, 157-159 (1977). The NAIC annual statement filed by petitioner reflects the amounts held by the company as reserves for dividends to policyholders. The amounts that the statute treats as a reserve for dividends are those amounts actually set aside for this purpose as of the end of the taxable year (with certain adjustments not here in issue). Treasury Regulations on Income Tax (1954 Code), Section 1.811-2(c)(1) (26 C.F.R.).

Petitioner, however, argues (Pet. 9-13) that Congress intended that any overestimate of opening reserves for dividends to policyholders for 1958 should be rectified by allowing such reserves to be adjusted, retroactively, to reflect the amount of dividends actually paid out in the initial year of taxability under the 1959 Act. To be sure, an amendment was offered in the Senate to accomplish this objective (Pet. App. A4-A5). But as the Court of Claims correctly observed (Pet. App. A5-A7), the Senate did not accept that amendment and the House of Representatives never considered it. Thus, not only did Congress not intend the result urged by petitioner; the Senate specifically rejected an attempt to amend the statute to allow such a result.

In holding that petitioner could not resuscitate the statutory amendment offered in 1959 and rejected by Congress, the decision of the Court of Claims is in accord with *Pacific Mutual Life Insurance Co.* v. *Commissioner*, 48 T.C. 118, 127-129 (1967), rev'd on other issues, 413 F. 2d 55 (9th Cir. 1969). There, the Tax Court rejected a similar contention that Congress intended to allow life insurance companies to employ "actuarial hindsight" and recompute their beginning insurance reserves for 1958 to reflect their actual claims experience on the policies in question.[3]

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[3]As in the instant case, the taxpayer in *Pacific Mutual* argued that an overstatement of opening insurance reserves for the first year in which such companies became taxable on underwriting income would result in a distortion of income that would not ultimately be corrected in a later year, and had cited the same legislative history.

Contrary to petitioner's argument (Pet. 8), the decision below and *Pacific Mutual* do not conflict with *Home Mutual Insurance Co.* v. *Commissioner*, 70 T.C. 944 (1978), appeal pending, Nos. 79-1602 and 79-1603 (7th Cir.). In *Home Mutual*, the Tax Court concluded that in computing its "losses incurred" deduction for 1963 under Section 832(b)(5) of the Code, a mutual casualty insurance company (which became taxable on its underwriting income for years beginning after December 31, 1962, under the Revenue Act of 1962, Pub. L. No. 87-834, Section 8, 76 Stat. 960) could adjust its estimated "unpaid losses" as of December 31, 1962, to reflect the lesser amounts it ultimately paid in settlement of those claims. To be sure, by permitting an adjustment based upon the actual experience of a mutual casualty insurance company to reflect the first year of the operation of the statute, the Tax Court's ruling in *Home Mutual* rests upon the "actuarial hindsight" rationale rejected by *Pacific Mutual* and the decision below. But *Home Mutual* involved an entirely different provision of the Code Section 832(b)(5)—and therefore does not conflict with the decision below. Indeed, the provision involved in *Home Mutual* deals exclusively with the computation of the taxable income of insurance companies other than life insurance companies. On the other hand, Section 811(b)—and the provisions at issue in *Pacific Mutual* are concerned solely with the taxation of life insurance companies.

2. Petitioner further argues (Pet. 10-13) that the Commissioner's refusal to allow its claimed adjustment is an abuse of discretion that should be corrected by this Court because a representative of the Secretary of the Treasury allegedly advised Congress by letter in 1958 that opening reserves could be adjusted to reflect actual payments. However, petitioner misstates the nature of the Treasury's 1958 letter to the Senate Finance Committee. The Treasury merely advised the Senate Finance

Committee that the reserve for dividends to policyholders at the end of 1957 could be corrected for "technical errors" such as those that might be caused, for example, "by the introduction of new data-processing equipment" (Pet. App. A5 n.6; 105 Cong. Rec. 8435 (1959)). This was simply a restatement of the traditional rule that reserves may be retroactively adjusted to correct mathematical errors, but may not be retroactively adjusted with the benefit of hindsight to correct errors of judgment in the original estimate. *Pacific Mutual Life Insurance Co.* v. *Commissioner*, *supra*, 48 T.C. at 129. But petitioner's overstatement of its reserve for dividends to policyholders in its 1957 NAIC annual statement was not due to a technical error of the sort referred to by the Treasury statement. Rather, it was the same kind of judgmental error that was involved in *Pacific Mutual*. Thus, the Commissioner's refusal to permit petitioner to adjust its opening reserves for 1958 is entirely consistent with the Treasury's 1959 letter to the Senate Finance Committee.[4]

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[4]Moreover, the Treasury's views were not communicated to the House of Representatives, which had approved the statutory provisions in question before they were referred to the Senate. Thus, as the Court of Claims below pointed out (Pet. App. A7), the House of Representatives could hardly have relied on the alleged promises by the Treasury Department to correct the opening reserves for dividends to policyholders for life insurance companies. In these circumstances, the Court of Claims properly concluded (*ibid.*), "we cannot find a *Congressional* intent to allow special treatment of the opening dividend reserve, especially in the face of an unambiguous statute which makes no mention of such treatment * * *" (emphasis in original).

3. Contrary to petitioner's final argument (Pet. 13-15), the question presented has no administrative importance. There has been little, if any, litigation involving the proper interpretation of the provisions of Section 811(b) here in question. Moreover, the decision affects only the computation of the dividends to policyholders deduction allowable to mutual life insurance companies for 1958. While a similar issue may be presented with respect to the computation of the "losses incurred" deduction allowable to mutual casualty companies for 1963 (see page 7, *supra*), the question is otherwise non-recurring and has no continuing importance as to the provisions involving the taxation of either life insurance or non-life insurance companies.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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